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INFO RUCNRAQ/IRAQ COLLECTIVE PRIORITY

C O N F I D E N T I A L SECTION 01 OF 03 BAGHDAD 003156

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TAGS: [ENRG](#) [EPEL](#) [IZ](#) [PREL](#)

SUBJECT: IRAQ'S DEPUTY PRIME MINISTER AND MINISTER OF OIL
ON HYDROCARBON POLICY, FUEL SHORTAGES AND OIL SECTOR BUDGET
PROBLEMS

REF: STATE 127497

Classified By: Charge d'Affaire, a.i., Daniel Speckhard, Reasons 1.5 (b)
) and (d).

¶1. (C) Summary: On August 24, the Charge held back-to-back meetings with Deputy Prime Minister Barham Salih and Minister of Oil Dr. Husayn Shahristani to discuss development of Iran's hydrocarbon legislation and the country's fuel crisis.

In both meetings he presented USG recommendations for a National Oil Framework (reftel). Barham Salih outlined his preference for a national hydrocarbon structure that includes overall policy direction and revenue collection by a national-level entity, coupled with operational management by regional companies. He disagreed with our formulation that Iraq's petroleum sector should be managed by national-level entity(s). Barham Salih, himself a Kurd, had just returned from a meeting with Kurdish officials. His report of those discussions indicated more opportunity for compromise between Baghdad's and the KRG's than a comparison of the proposed hydrocarbon legislation drafted by each side would indicate. Shahristani expressed a preference for a strong central responsibility for oil resources although recognized the need for a role for the regions. However according to Shahristani, the Ministry of Oil would be a regulator, not a manager. He welcomed US assistance in reviewing the draft hydrocarbon law that his ministry is preparing. End Summary.

Meeting With Deputy Prime Minister Barham Salih

¶2. (C) On August 24, the Charge met with Deputy Prime Minister Barham Salih to present USG views on the development of Iraq's hydrocarbon law. Utilizing the talking points provided reftel, the Charge outlined our concept of a National Oil and Gas Framework in which the petroleum sector is managed by national-level entities with regional participation. Barham Salih's initial reaction was to strongly disagree with national-level management of the industry. He was more accepting of our suggestions concerning revenue sharing, national oil policy, and transparency and anti-corruption, with oversight by a new federal entity in Baghdad, such as the "Supreme Oil Policy Council". Salih stated that the political reality at the moment is that to "push too far is no good," and that it is necessary, at this point, to "tame the excesses." He also strongly expressed the opinion that Baghdad is the "ultimate source of corruption" as an underlying reason to moderate central control.

¶3. (C) Salih's personal view of an industry structure includes 1) all revenue flows to the center; 2) oil policy set at the national level; 3) structure and management should produce maximum revenue; 4) three competing regional companies would provide management; and 5) governance would

be the province of a Supreme Oil Policy Council. The Supreme Oil Council would have representatives from all regions as well as the center. It would "set terms - all aspects of oil policy." Under this model, the regional oil companies would run the fields and negotiate oil contracts, but the contracts would have to be approved by a central body. Salih stated emphatically that the Supreme Oil Policy Council should NOT/NOT be the Ministry of Oil, which he characterized as "not reformable."

¶4. (C) The Charge asked Salih whether the KRG would accept Salih's proposal, especially since the KRG- proposed hydrocarbon law strongly emphasized regional control. Salih, himself a Kurd, had just returned from talks in Kurdistan with KRG officials. He said the Kurdish leaders were in agreement with most of the principles that he outlined above.

The primary area of disagreement was contracts, which the KRG is insisting be negotiated solely by regional entities. Salih said some compromise is necessary. He added that the GOI should have representatives on the board of directors of the KRG oil company.

¶5. (C) At the end of the August 24 meeting, Barham provided the Charge with a non-paper on the petroleum law drawn up by the Kurds. The points state three main principles: 1) the Constitution must be the basis for the law; 2) the law should be modern, clear and transparent; and 3) the law must create a framework for investment that maximizes timely returns for all the people of Iraq. The paper also included major issues that the law must address, indicating the relevant article of the Constitution as appropriate: 1)revenue sharing (%) for KRG and each governate - Article 112; 2)revenue distribution to be handled by an Independent Revenue Commission; 3)management of current fields - federal/regional/joint -

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Article 112; 4)management of new fields - Article 115; 5)organizations and structures; 6)role/authorities of the petroleum/energy committee; 7)authorization, contracts and management of operations, and 8)investment models to provide maximum returns to Iraq. (Note: The talking points clearly indicate that revenue sharing should be a percentage, supporting the KRG position against pro rata sharing based on population. They are against such a formula because they feel the Sh,ia have larger families. End Note.)

¶6. (C) Lastly, the Charge and Salih briefly discussed MoO's difficulties in receiving its capital improvement and operating budgets. The Senior Consultant from the Iraq Reconstruction Management Office (IRMO), who accompanied the Charge to the meeting, stated that MoO had spent less than \$1.0Bn of its allocated \$3.5Bn capital expenditures budget during FY2006. The problem appeared to be the inability of MoO to receive an overall, annual approved budget. Ministry officials therefore had to go through separate approval procedures for any project/item over \$10M. The IRMO consultant stated that the same held true for MoO's repair and maintenance budget. The Ministry is unable, due to procurement constraints, to efficiently purchase and stockpile spare parts in a manner that would facilitate timely repair of inoperative equipment. He warned that if this is allowed to continue, the degradation of the oil industry's infrastructure will significantly hamper the GOI's plans to maximize oil revenue. The consultant contrasted the present situation to the end of the Iran-Iraq war, when MoO was given a budget and streamlined contracting authority to repair the damage that occurred during the war. Salih professed to be surprised at this concern, stating that the High Contracts Commission (HCC) had approved all but two of MoO's major budget requests. He said the problem was therefore with the MoO, but he offered no opinion as to how to correct the situation.

Meeting with Minister of Oil Husayn Shahristani

¶ 7. (C) Immediately following the Salih meeting, the Charge met with Minister of Oil Husayn Shahristani. Shahristani began by briefly outlining the status of MoO's draft hydrocarbon law. He said the draft (which post had received a copy of two days prior to this meeting) was lengthy and constantly under revision, but it was a starting point. He estimated that it will take weeks to finalize, after which it will go to the Cabinet and Parliament. He said that the proposed law had been drafted by four former Iraqi hi-level technocrats.

¶ 8. (C) The Charge inquired if Shahristani thought the draft would be acceptable to the KRG. Shahristani, smiling, said the KRG draft law conveys the impression that the GOI-KRG negotiations are between two countries instead of between a country and a region.

¶ 9. (C) Shahristani stated that the Kurds are comfortable with the following: 1) oil belongs to all the Iraqi people; 2) revenues flow to the center; 3) the budget is basically national; 4) Iraq should have one national oil policy, including national determination of which fields will be developed; 5) establishing national models/types of contracts; and 6) national determination of which fields will be developed first (as long as it is balanced) and what type of contract/tender will be used. Shahristani confirmed Salih's statement that the only point of disagreement was that the Kurds want complete control over negotiating oil agreements. Shahristani felt that contracts should be handled at the national level. He summarized the situation by stating that the Kurdish position "provides a basis for agreement on a hydrocarbon law." Shahristani said that he is nervous, however, about the Kurds signing oil contracts without a hydrocarbon law in place. Note: Subsequent meetings with Kurdish representatives suggest there may be additional significant disagreements between the KRG and the Central Government as discussed in septel. End Note.

¶ 10. (C) The Charge then briefed the Minister on his presentation to DPM Salih. Shahristani agreed with Salih that the MoO should be a regulator, not a manager. Management should be left to an Iraqi National Oil Company, a holding company for the regional oil companies. The regional companies would be allowed to compete with each other and negotiate joint ventures with the international oil companies (IOCs).

¶ 11. (C) Turning to draft MoO hydrocarbon law, the Charge and the AID consultant on petroleum law, who also accompanied the Charge to the meeting, told Shahristani that the draft needed

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more definition between regulatory and operating rules. Shahristani said he wants our comments on MoO's draft law and he confirmed that post had the latest draft.

¶ 12. (C) The Charge next raised the same budget issues with Shahristani that he had raised earlier with Salih. Shahristani stated that even if the HCC approved projects quickly, Salih himself often sat on the approval document for two weeks before signing it. In a subsequent meeting, Barham denied this charge. Shahristani basically agreed that government-wide bureaucratic procedures for processing budget allocations were a serious problem. He attributed this to a culture that had lived for too long under an authoritarian regime, in which people were, and still are, afraid to make independent decisions. This problem recently had been exacerbated by the government's anti-corruption drive, which made officials, especially those serving on bid committees, afraid to authorize monetary expenditures lest they be accused of corruption. Shahristani also complained that the Ministry of Finance was attempting to insert itself too deeply into the project approval process.

¶ 13. (C) Shahristani said that, with regard to the MoO's surplus of over \$2.0Bn, that would be dealt with within a few

months when the ministry solicits bids to build two new refineries. (Comment: Post is aware of only one refinery project that the Iraqi's are currently putting out for bid. To date, they have received only one bidder. We do not believe that Shahristani and MoO can finalize any refinery project "within a few months." End Comment)

¶14. (C) The Charge asked Shahristani what progress the GOI was making in alleviating the fuel shortage by importing petroleum products. The Minister said that they were still in disagreement with Turkey, which insisted that Iraq pay all claimed arrears for petroleum products before the GOT will let its companies sell more product to Iraq. Since some of the charges are under dispute, Iraq did not believe that it could simply pay the total asked for. Shahristani added that they did not understand why the Turkish Ministry of Foreign Trade had inserted itself into this affair, including mandating that the GOI purchase from 33 Turkish companies. Some of which he claimed were not even in the fuel business, but were in the textile or food business. He said that many of the companies have ties to Turkish politicians.

¶15. (C) Lastly, the Charge asked Shahristani about his recent trip to Iran and the MOU that he had signed in Tehran. Shahristani said that the principal purpose for the MOU was to agree to a process for unitization of the oil fields that span the Iraq-Iran border, which Iran is already exploiting. (Unitization determines the arrangement between operators when one or both is exploiting a shared oil field.) Shahristani said that they hoped also to conclude unitization agreements with Kuwait and Syria. Iran also agreed to export small quantities of LPG and kerosene to Iraq. The Iranians, in exchange, want Iraqi crude from Kirkuk and Basrah.

SPECKHARD